

Introduction to Franchising

1.1 Introduction

Welcome to SBA's online training course: Introduction to Franchising

The SBA's Office of Entrepreneurship Education provides this self-paced training exercise as An Introduction to Franchising basics. You will find this course easy to follow and the subject matter indexed for quick reference and easy access. It will take about 30 minutes to complete the course. Additional time will be needed to review included resource materials and to complete the suggested next steps at the end of the course.

As audio is used throughout the training, please adjust your speakers accordingly. A transcript and keyboard shortcuts are available to further assist with user accessibility.

When you complete the course, you will have the option of receiving a completion confirmation from the SBA.

1.2 Course Objectives

This course has four key objectives.

One, define franchising and the types of franchises.

Two, explain the pros and cons of owning a franchise.

Three, discuss the components of a Franchise Disclosure Document.

Four, identify resources to assist you in franchising a business.

1.3 Course Topics

There are several topic sections within the course. Each section covers a different aspect of franchising. Some of the areas covered include:

- Definition of franchising
- The pros and cons of owning a franchise
- Investigating your options
- Is franchising right for you?

Numerous additional resources are identified to assist you. Visit the resource icon in the course player or locate additional tools, templates, and mentors on SBA.gov once you finish the course.

Let's get started!

1.4 What Is Franchising?

Owning your own franchise can be a great way to start a small business without taking on the risks that are associated with starting from scratch.

A franchise is a license to use the name, trademarks, and proprietary products of an existing company. Owning a franchise allows you to distribute the company's products as well as to use

their business systems. These may include national marketing, accounting, point-of-sales information, site selection, and site acquisition.

In exchange for these rights and services, the franchisor receives an upfront fee for the rights to a geographic area, as well as royalties based on sales.

1.5 Types of Franchises

There are two primary forms of franchising: product/trade name franchising and business format franchising.

In product /trade name franchising, a franchisor owns the right to the name or trademark and sells that right to a franchisee. This is most often seen in the soft drink or automotive industry, where a product is sold or distributed through a franchisee.

Business format franchising is when the franchisor and franchisee have an ongoing relationship, and the franchisor provides a full range of services, including site selection, training, product supply, marketing plans, and even assistance in obtaining financing.

1.6 The Pros and Cons of Owning of a Franchise

In order to determine whether franchising is right for you, you must first evaluate the pros and cons.

A good franchise offers site selection assistance, training, purchasing power, marketing plan, brand recognition, and financing.

The cons of owning a franchise include the lack of control of certain business decisions, such as marketing and product offerings; the length of contracts; and the cost of exiting the franchise.

1.7 Investigating Your Options

There are approximately 3,000 different franchise companies operating in 80 different industries. So how do you know which company is right for you? The answer is Market Research.

Franchise opportunities can be identified through Internet research, in magazines such as Entrepreneur, Success, and Inc., or in various trade journals such as the Franchising World, Wall Street Journal and USA Today.

You can also reach out to franchisors to help you during this process.

1.8 Research the Franchisor

Once you have conducted market research and decided on a business that you are interested in, the next step is to research the franchisor. You risk losing a significant amount of money if you do not investigate a business carefully before you buy.

By law, franchise sellers must disclose certain information about their business to potential buyers. Make sure you get all the information you need first, before entering into this form of business.

Consider the following questions during your research:

1. How long has the franchisor been in the industry?

2. How many are currently operating in your area?
3. What is the financial health of the franchisor?
4. Are there any current or pending legal issues faced by the franchisor?

Take the time to talk to other franchisees to get a first-hand account of their experience with the franchisor.

1.9 Franchise Package

During your research, you will also want to take a detailed look at the franchise package to see what is included.

- Are there are licensing or other fees?
- Is a land and/or building purchase or lease required?
- What equipment is needed and/or provided?
- How long is the contract?
- What training is provided?
- What level of inventory is needed to get started?
- What other costs will need to be paid to the franchisor? Royalties, advertising, insurance?

1.10 The Franchise Disclosure Document (FDD)

Once you identify a company that you are curious about, the next step is to request and read thoroughly the Franchise Disclosure Document, or FDD. The FDD defines what the franchisor will do for you and what is expected of you. Each franchisor is legally required to provide this document to potential franchisees.

There are 23 important sections to the FDD.

- Sections 1 through 4 contain information pertaining to the history of the franchisor company, their business experience, litigation, and bankruptcy details (if applicable).
- Sections 5 through 10 outline the fees associated with the franchise, such as initial investment costs, royalties, advertising fees, and all financial arrangements, including restrictions as to sources of products and services.
- Sections 11 through 19 detail the franchisee's obligations and provisions in the agreement. These are very important, as they define what restrictions there are on products that can be sold, transfer assignments, terminations, and dispute resolutions. This section also includes information about advertising, computer systems, and training.
- Sections 20 through 23 provide a list of existing franchisees, those that are active and those that have left the company. They also provide financial statements of the franchisor and copies of contracts used in connection with the franchise offering, including the Franchise Agreement.

1.11 Personal Assessment

Before you decide to invest in a franchise, you should first ask yourself a few important questions relating to your personal ambitions, goals, and needs.

Consider the following questions:

- What is your experience level?
- What are your abilities?
- What is your education level?
- What are your goals?
- What is your financial situation?
- Do you know how much you can invest?

Remember, this is about you. Focus on the best possible company that will be able to meet all of your needs.

1.12 Advice and Counseling

During this process you should also consider seeking advice from franchise consultants, franchise attorneys, accountants, and other business experts.

- The primary goal of the franchise consultant is to match the needs, skill sets, and business objectives of the prospective franchisee with the right franchise and franchisor. A franchise consultant also helps guide the research process and can offer advice on financing options.
- A franchise attorney will help you review the lease agreement and the incorporation documents, as well as providing relevant legal advice.
- The franchise accountant will help you by reviewing the franchisor's financials.
- A reliable lender will help secure the financing that best fits your business model.
- And a professional site locator is valuable in selecting and securing the right site for your franchise.

It is important to find organizations and individuals that can guide you every step of the way during your research before you decide to purchase a franchise. Networking with other business owners, Chambers of Commerce, and friends are some approaches to finding help.

1.13 Summary

Now that we've covered the basics of franchising, you should be able to:

- Define franchising and the types of franchises
- Explain the pros and cons of owning a franchise
- Discuss the components of a Franchise Disclosure Document
- Identify resources to assist you in franchising a business

1.14 Next Steps

If you are serious about franchising a business, consider taking the following steps:

- **Step 1: Be a Detective.** In addition to the routine investigation that should be conducted prior to any business purchase, contact other franchisees before deciding to invest. You can obtain a Uniform Franchise Offering Circular (UFOC), which contains vital details about the franchise's legal, financial, and personnel history, before you sign a contract.
- **Step 2: Know What You are Getting Into.** Before entering into any contract as a franchisee, you should make sure that you would have the right to use the franchise name and trademark, receive training and management assistance from the franchisor, use the franchisor's expertise in marketing, advertising, facility design, layouts, displays, and fixtures, and do business in an area protected from other competing franchisees.
- **Step 3: Seek Professional Help.** The tax rules surrounding franchises are often complex, and an attorney, preferably a specialist in franchise law, should assist you in evaluating the franchise package and tax considerations. An accountant may be needed to determine the full costs of purchasing and operating the business, as well as to assess the potential profit to the franchisee.

1.15 Resources

SBA has a broad network of skilled counselors and business development specialists. Below is a short description of our resource partners:

- **Small Business Development Centers (SBDCs)** are associated with institutions of higher education – universities, colleges, and community colleges. More than 900 SBDCs offer no-cost, extensive, one-on-one, long-term professional business advising, low-cost training, and other specialized services such as procurement, manufacturing, and technology assistance, which are critical to small business growth.
- **SCORE** offers free, confidential small business advice from successful entrepreneurs. SCORE is a nationwide program and boasts more than 12,000 volunteers to give you guidance to grow your business.
- **Women's Business Centers (WBCs)** provide free management and technical assistance to help women and men start and grow small businesses. There are over 100 WBCs located throughout the U.S. and Puerto Rico.
- **SBA's 84 District and Branch offices** connect entrepreneurs to resources, products, and services that can help them start, manage, and grow their business. These offices are located in all 50 states, Puerto Rico, the U.S. Virgin Islands, and Guam.
- **The SBA Learning Center** is an online portal that hosts a variety of self-paced online training courses, quick videos, web chats, and more to help small business owners explore and learn about the many aspects of business ownership. Content is filtered by topic, so no matter what the stage of your business, or the kind of insight you need, you can quickly get answers.

Find your local resource using our handy ZIP-code tool by visiting www.sba.gov/local-assistance.

1.16 Have a Question?

- Call SBA at 1-800 U ASK SBA (1-800 827-5722)
- E-mail SBA at answerdesk@sba.gov
- Locate a SCORE counselor, SBA District Office near you, or an SBDC office near you at www.sba.gov/local-assistance
- To provide feedback, comments, or suggestions for other SBA online content, please email: learning@sba.gov

1.17 Certificate

Congratulations on completing this course. We hope it was helpful and provided a good working knowledge of franchising. Click the certificate to receive a course completion confirmation from the U.S. Small Business Administration.